



Report to the Subcommittee on
Readiness and Management Support,
Committee on Armed Services,
U.S. Senate

July 2014

AIR FORCE WORKING CAPITAL FUND

Actions Needed to Manage Cash Balances to Required Levels

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GAO Highlights

Highlights of [GAO-14-480](#), a report to the Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

Why GAO Did This Study

The AFWCF earned revenue of \$21.2 billion in fiscal year 2013 by, among other things, (1) repairing aircraft and engines; (2) selling inventory items (parts); and (3) providing air, land, and sea transportation. Cash generated from the sale of goods and services is used by the AFWCF to cover its expenses, such as paying employees. As requested, GAO reviewed issues related to AFWCF cash management.

GAO's objectives were to determine to what extent (1) the AFWCF monthly cash balances were within the DOD minimum and maximum cash requirements for fiscal years 2009 through 2013 and (2) the AFWCF projected monthly cash balances were within the minimum and maximum cash requirements for fiscal years 2014 and 2015 and if not why. To address these objectives, GAO reviewed relevant DOD cash management guidance, analyzed AFWCF actual and projected cash balances and related data, and interviewed Air Force and United States Transportation Command officials.

What GAO Recommends

GAO is making three recommendations to DOD that are aimed at implementing the Department of the Treasury's daily cash balance initiative and ensuring that the AFWCF receives the appropriate funding if a cash shortfall occurs because of a lack of ARA funding or estimated savings not being realized. DOD concurred with GAO's recommendations and cited related actions planned or under way.

View [GAO-14-480](#). For more information, contact Asif A. Khan at (202) 512-9869 or khana@gao.gov.

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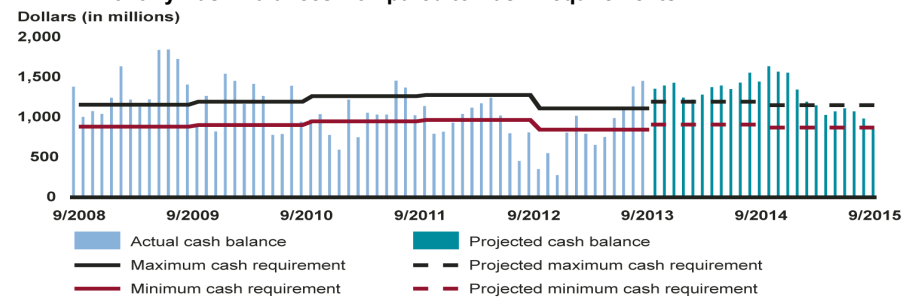
AIR FORCE WORKING CAPITAL FUND

Actions Needed to Manage Cash Balances to Required Levels

What GAO Found

GAO's analysis of Air Force Working Capital Fund (AFWCF) cash data showed that monthly cash balances fell within the minimum and maximum cash requirements about one-third of the time in fiscal years 2009 through 2013. GAO identified three reasons why monthly cash balances were above the maximum or below the minimum cash requirements. First, the cash balance began fiscal year 2009 above the maximum requirement and generally remained above the maximum requirement in fiscal years 2009 and 2010 because the AFWCF charged more than it cost for spare parts. Second, cash balances fluctuated each year because of the cyclical nature of events. For example, in the spring and summer months, the Air Force flies more training missions, which increases revenue for parts and thus the cash balance. Finally, large-dollar transactions caused cash balances to fluctuate above and below cash requirements. These transactions were used to increase cash to pay for costs such as fuel price increases or reduce cash if it was above the maximum requirement.

AFWCF Monthly Cash Balances Compared to Cash Requirements



AFWCF projected monthly cash balances are expected to fall within cash requirements about 25 percent of the time in fiscal years 2014 and 2015. In managing cash for those fiscal years, the AFWCF faces three challenges:

- The AFWCF plans to implement a Department of the Treasury initiative to provide daily cash balances, instead of monthly balances, in October 2014. Because daily balances are more volatile, the AFWCF faces a greater risk that a cash shortfall would occur. However, the Department of Defense (DOD) has not updated its regulation on receiving daily cash balances.
- Because airlift rates are set to compete with private sector rates, they do not cover the full cost. The difference between the full cost and revenue received is to be provided by the Airlift Readiness Account (ARA) funded by the Air Force. The projected cash balance declines in fiscal year 2015 because the Air Force did not fully fund the ARA by \$927 million. If a cash shortfall materializes, the Air Force stated its intent to fund the requirement from other programs. Without sufficient ARA funding, the AFWCF cash balance is at risk of falling below the minimum cash requirement in fiscal year 2015.
- The AFWCF has included \$620 million in savings from Air Force and United States Transportation Command initiatives in its fiscal year 2015 projected monthly cash balances. If these savings are not realized, the Air Force may need to take action to reduce the risk of a cash shortfall.

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Abbreviations

AFWCF	Air Force Working Capital Fund
ARA	Airlift Readiness Account
CSAG	Consolidated Sustainment Activity Group
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
SMAG-R	Supply Management Activity Group-Retail
TWCF	Transportation Working Capital Fund
USTRANSCOM	United States Transportation Command

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July 31, 2014

The Honorable Jeanne Shaheen
Chairman
The Honorable Kelly Ayotte
Ranking Member
Subcommittee on Readiness and Management Support
Committee on Armed Services
United States Senate

The Air Force operates the Air Force Working Capital Fund (AFWCF) to provide certain goods and services to a variety of customers, including the Army, the Navy, the Air Force, non-Department of Defense (DOD) agencies, and foreign countries. Under the working capital fund concept, the Air Force charges these customers for the anticipated full cost of these goods and services. In fiscal year 2013, the AFWCF earned revenue of \$21.2 billion by, among other things, (1) repairing, overhauling, and modifying aircraft, engines, missiles, and components; (2) selling depot-level repairable and consumable inventory items to customers; and (3) providing air, land, and sea transportation for DOD in times of peace and war, with a primary focus on wartime readiness.

The availability of cash in the AFWCF depends on the outcome of many decisions made during DOD's budget process with regard to (1) projecting workloads, (2) estimating costs, and (3) setting prices to recover the estimated full cost of providing goods and services. The AFWCF cash balance is directly affected by collections from the sale of goods and services, disbursements for such items as salaries and the purchase of inventory, appropriations passed by Congress and enacted into law, and transfers in and out of the AFWCF.¹ According to the DOD Financial Management Regulation,² "cash levels should be maintained at 7 to 10 days of operational cost and six months of capital

¹A transfer is the shifting of budget authority from one appropriation or fund account to another. Agencies may transfer budget authority only as authorized by law.

²The DOD Financial Management Regulation directs statutory and regulatory financial management requirements, systems, and functions for all appropriated and nonappropriated, working capital, revolving, and trust fund activities. See DOD Financial Management Regulation 7000.14-R, *Introduction*, p. I-3 (June 2011).

disbursements,”³ (hereafter referred to as the cash requirement).⁴ Thus, the minimum cash requirement consists of cash that is sufficient to meet 6 months of capital requirements plus 7 days of operational cost. The maximum cash requirement consists of 6 months of capital requirements plus 10 days of operational cost. The Air Force may add certain adjustments to the calculation if approved by DOD. A disbursement in excess of available cash would potentially constitute an Antideficiency Act violation.⁵ If the AFWCF builds excess cash balances, it is subject to reduced budget requests by DOD, reduced appropriations from Congress, or transfers from the AFWCF to other appropriation accounts. For example, Congress reduced the Air Force’s fiscal year 2010 Operation and Maintenance appropriation by \$250 million because of excess cash in the AFWCF. Consequently, it is important for the AFWCF to manage its cash balance to stay within the minimum and maximum cash requirements as much as possible.

You asked us to review issues related to AFWCF cash management. Our objectives were to determine to what extent (1) the AFWCF monthly cash balances were within the DOD minimum and maximum cash requirements for fiscal years 2009 through 2013 and (2) the AFWCF projected monthly cash balances were within the minimum and maximum cash requirements for fiscal years 2014 and 2015 and if not why.

To address the first objective, we (1) obtained the DOD regulation on calculating the minimum and maximum cash requirements, (2) calculated the cash requirements for fiscal years 2009 through 2013 based on the regulation, and (3) obtained monthly cash balances for fiscal years 2009 through 2013. We compared the minimum and maximum cash requirements to end-of-month reported cash balances. If the cash

³Capital disbursements are purchases of assets that equal or exceed capitalization thresholds and have a useful life of 2 or more years. For minor construction projects, the capitalization threshold is \$100,000; for all other assets, the capitalization threshold is \$250,000. See DOD Financial Management Regulation 7000.14-R, *Defense Working Capital Funds Activity Group Analysis*, vol. 2B, ch. 9, p. 9-8 (June 2010).

⁴See DOD Financial Management Regulation 7000.14-R, *Defense Working Capital Funds Activity Group Analysis*, vol. 2B, ch. 9, p. 9-6 (June 2010).

⁵The Antideficiency Act, 31 U.S.C. §§ 1341(a)(1), 1517, provides that no officer or employee of the government shall make or authorize an expenditure or obligation exceeding the amount of an appropriation, fund, or apportionment available for expenditure or obligation.

balances were above the maximum amount or were below the minimum amount, we met with Air Force and United States Transportation Command (USTRANSCOM) officials and reviewed AFWCF budgets and other Air Force and USTRANSCOM documentation to ascertain the reasons.⁶ Further, to determine the extent to which cash transfers for fiscal years 2009 through 2013 resulted in the AFWCF cash balances either falling below the minimum cash requirement or being above the maximum cash requirement, we analyzed DOD budget and accounting reports to determine the dollar amount of transfers made for the period. We analyzed cash transfers to determine if any of the transfers resulted in the cash balances falling outside the minimum or maximum cash requirements and, if so, the amount that fell outside those requirements. We also obtained and analyzed reprogramming documents and journal vouchers and interviewed key Air Force and USTRANSCOM officials to determine the reasons for the transfers.

To address the second objective, we obtained and analyzed AFWCF budget documents and cash management plans for fiscal years 2014 and 2015. We used the DOD regulation to calculate the minimum and maximum cash requirements for those years and compared it to the projected cash balances. If the projected cash balances were above or below the cash requirement, we met with Air Force and USTRANSCOM officials to ascertain the reasons. Further, we interviewed Office of the Under Secretary of Defense (Comptroller), Air Force, and USTRANSCOM officials on the Department of the Treasury (Treasury) initiative to begin receiving daily cash balances in fiscal year 2015 and the potential effect on the management of AFWCF cash. We also interviewed Air Force and USTRANSCOM officials to determine what actions the AFWCF plans to take to increase collections or decrease disbursements to avoid potential AFWCF cash shortages.

We obtained the AFWCF financial data in this report from official budget documents and accounting reports. To assess the reliability of these data, we (1) reviewed and analyzed the factors used in calculating the minimum and maximum cash requirements for the completeness of the elements included in the calculation; (2) interviewed Air Force,

⁶USTRANSCOM operates the Transportation Working Capital Fund, which is part of the AFWCF.

USTRANSCOM, and Defense Finance and Accounting Service (DFAS)⁷ officials knowledgeable about the cash data; (3) compared AFWCF cash balance information, including collections and disbursements that were contained in different reports, to ensure that the data reconciled; (4) obtained an understanding of the process used by DFAS to reconcile AFWCF cash balances with Treasury records; and (5) obtained and analyzed documentation supporting the amount of funds transferred in and out of the AFWCF. On the basis of procedures performed, we have concluded that these data were sufficiently reliable for the purposes of this report. A more detailed discussion of our scope and methodology is contained in appendix I.

We conducted this performance audit from July 2013 to July 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The AFWCF relies on sales revenue rather than regular appropriations to finance its continuing operations. The AFWCF is intended to (1) generate sufficient resources to cover the full cost of its operations and (2) operate on a break-even basis over time—that is, neither make a gain nor incur a loss. Customers primarily use appropriated funds to finance orders placed with the AFWCF. Cash generated from the sale of goods and services is the AFWCF's primary means of maintaining an adequate level of cash to sustain its operations. The ability to generate cash consistent with DOD's regulations depends on (1) accurately projecting workload, such as the number of aircraft, engines, missiles, and components needed to be repaired during the year or annual transportation requirements needed to move United States forces, equipment, and supplies around the globe, and (2) accurately setting prices to recover the full costs of producing goods and services. DOD policy requires the AFWCF to establish its sales prices prior to the start of each fiscal year and to apply these predetermined or "stabilized" prices to most orders received during the

⁷DFAS performs accounting and disbursement functions for the military services and defense agencies.

year—regardless of when the work is accomplished or what costs are incurred. Stabilized prices provide customers with protection during the year of execution from prices greater than those assumed in the budget and permits customers to execute their programs as approved by Congress.

Developing accurate prices is challenging because the process to determine the prices begins about 2 years in advance of when the work is actually received and performed. In essence, the AFWCF's budget development has to coincide with the development of its customers' budgets so that they both use the same set of assumptions. To develop prices, the AFWCF estimates (1) labor, material, overhead, and other costs based on anticipated demand for work as projected by customers; (2) total direct labor hours for each type of work performed, such as work related to aircraft, engines, and repairable inventory items; (3) the workforce's productivity; and (4) savings because of productivity and other cost avoidance initiatives. In order for the AFWCF to operate on a break-even basis, it is extremely important that the AFWCF accurately estimate the work it will perform and the costs of performing the work. Higher-than-expected costs or lower-than-expected customer demand for goods and services can cause the working capital fund to incur losses. Conversely, lower-than-expected costs or higher-than-expected customer demand for goods and services can result in profits. With sales prices based on assumptions that are made as long as 2 years before the prices go into effect, some variance between expected and actual costs is inevitable.

If projections of cash disbursements and collections indicate that cash balances will drop below the minimum cash requirement, the AFWCF may need to generate additional cash. One method that may be used is to bill customers in advance for work not yet performed. Advance billing generates cash almost immediately by billing AFWCF customers for work that has not been completed. This method is a temporary solution and is only used when cash reaches critically low balances because it requires manual intervention in the normal billing and payment processes.

Description of the AFWCF

During fiscal year 2013, the AFWCF earned \$21.2 billion in revenue. The AFWCF consists of three business entities: the Consolidated Sustainment Activity Group (CSAG), the Supply Management Activity Group-Retail (SMAG-R), and the Transportation Working Capital Fund (TWCF). The Air Force manages the CSAG and the SMAG-R and acts as an executive agent for the TWCF. The Air Force assumed responsibility for TWCF

cash in fiscal year 1998 and TWCF cash is included in the AFWCF cash balance.⁸ However, USTRANSCOM rather than the Air Force has the day-to-day management responsibility for TWCF operations. The following is a description of the three business entities.

- **CSAG:** During fiscal year 2013, the CSAG earned \$7.4 billion in revenue. The CSAG provides repairable supply items and consumable supply items as well as maintenance services.⁹ The Air Force operates two CSAG divisions: the supply division and the maintenance division. The supply division is primarily responsible for managing repairable and consumable spare parts unique to the Air Force. The supply division issued about 1.7 million repairable or consumable spare parts in fiscal year 2013. The maintenance division is responsible for economically repairing, overhauling, and modifying aircraft, engines, missiles, and components to meet customer demands. The Air Force operated three air logistics complexes performing about 21 million direct labor hours of work in fiscal year 2013.
- **SMAG-R:** During fiscal year 2013, the SMAG-R earned \$3.3 billion in revenue. The Air Force's SMAG-R manages inventory items, including weapon system spare parts, medical-dental supplies and equipment, and other supply items used in non-weapon system applications. It also procures material and makes spare parts available to authorized customers. The SMAG-R comprises three divisions: the General Support Division, the Medical-Dental Division, and the United States Air Force Academy Division. The General Support Division manages nearly 1.4 million items procured from the Defense Logistics Agency¹⁰ and the General Services Administration

⁸The AFWCF cash balance is the AFWCF Fund Balance with Treasury. According to DOD Financial Management Regulation 7000.14-R, *Accounting for Cash and Fund Balances with Treasury*, vol. 4, ch. 2, p. 2-4 (December 2009), the Fund Balance with Treasury is an asset account that reflects the available budget spending authority of federal agencies. Collections and disbursements will correspondingly increase or decrease the balance in the account. For the purposes of this report, we will refer to the Fund Balance with Treasury as cash.

⁹Repairable supply items are spare parts that can be economically repaired or overhauled. Consumable supply items are consumed in use or discarded when worn out or broken because they cannot be repaired economically.

¹⁰The Defense Logistics Agency is DOD's largest logistics combat support agency, providing worldwide logistics support to the military services as well as civilian agencies and foreign countries.

to support field and depot maintenance of aircraft, ground and airborne communication, and electronic systems. The Medical-Dental Division manages items for 74 medical treatment facilities worldwide. Finally, the United States Air Force Academy Division purchases uniforms and uniform accessories for sale to approximately 4,000 cadets at the Air Force Academy.

- **TWCF:** During fiscal year 2013, the TWCF earned \$10.5 billion in revenue. USTRANSCOM's mission is to provide air, land, and sea transportation for DOD in times of peace and war, with a primary focus on wartime readiness. USTRANSCOM submits the TWCF budget as a distinct subset of the AFWCF budget submission. It reflects the authority needed to meet peacetime operations, overseas contingency operations,¹¹ the surge/readiness requirements to support military strategy, and other priorities needed to meet its transportation mission. According to the USTRANSCOM fiscal year 2012 annual report, the airlift component of USTRANSCOM flew almost 85,000 sorties supporting 31,181 missions around the world and transported over 1.8 million passengers and 659,000 short tons of cargo to their destinations in fiscal year 2012. Further, the sealift and surface movement components of USTRANSCOM moved more than 500,000 measurement tons of cargo (sea transportation) and 14.5 million square feet of cargo (surface transportation) in support of U.S. forces worldwide in fiscal year 2012.¹²

DOD Cash Management Policy

Effective cash management in DOD largely depends on managers receiving accurate and timely data on cash balances, collections, and disbursements. Currently, DOD cash balances are visible only in official reports at the end of each month. According to DOD's Financial Management Regulation, volume 2B, chapter 9, DOD working capital funds are to maintain the minimum cash balance necessary to meet disbursement requirements in support of both operations and the capital asset program. The DOD working capital funds are to maintain a

¹¹In 2009, we reported that starting with the fiscal year 2009 supplemental request in April 2009, the administration now refers to funds for the operations in Iraq and Afghanistan as Overseas Contingency Operations funds. GAO, *Overseas Contingency Operations: Reported Obligations for the Department of the Defense*, [GAO-09-791R](#) (Washington, D.C.: July 10, 2009).

¹²USTRANSCOM did not prepare an annual report for fiscal year 2013. Information on fiscal year 2013 air, sea, and surface transportation operations by USTRANSCOM were not readily available.

minimum cash balance sufficient to pay bills, such as (1) paying employees' salaries for repairing aircraft, weapon systems, and equipment; (2) purchasing inventory items (spare parts) from vendors; and (3) transporting troops, equipment, and supplies worldwide. DOD's Financial Management Regulation requires that "cash levels should be maintained at 7 to 10 days of operational cost and cash adequate to meet six months of capital disbursements." Thus, the minimum cash requirement consists of cash that is sufficient to meet 6 months of capital requirements plus 7 days of operational cost.¹³ The maximum cash requirement consists of 6 months of capital requirements plus 10 days of operational cost. The regulation further provides that a goal of DOD working capital funds is to minimize the use of advance billing of customers to maintain cash solvency unless advance billing is required to avoid Antideficiency Act violations.

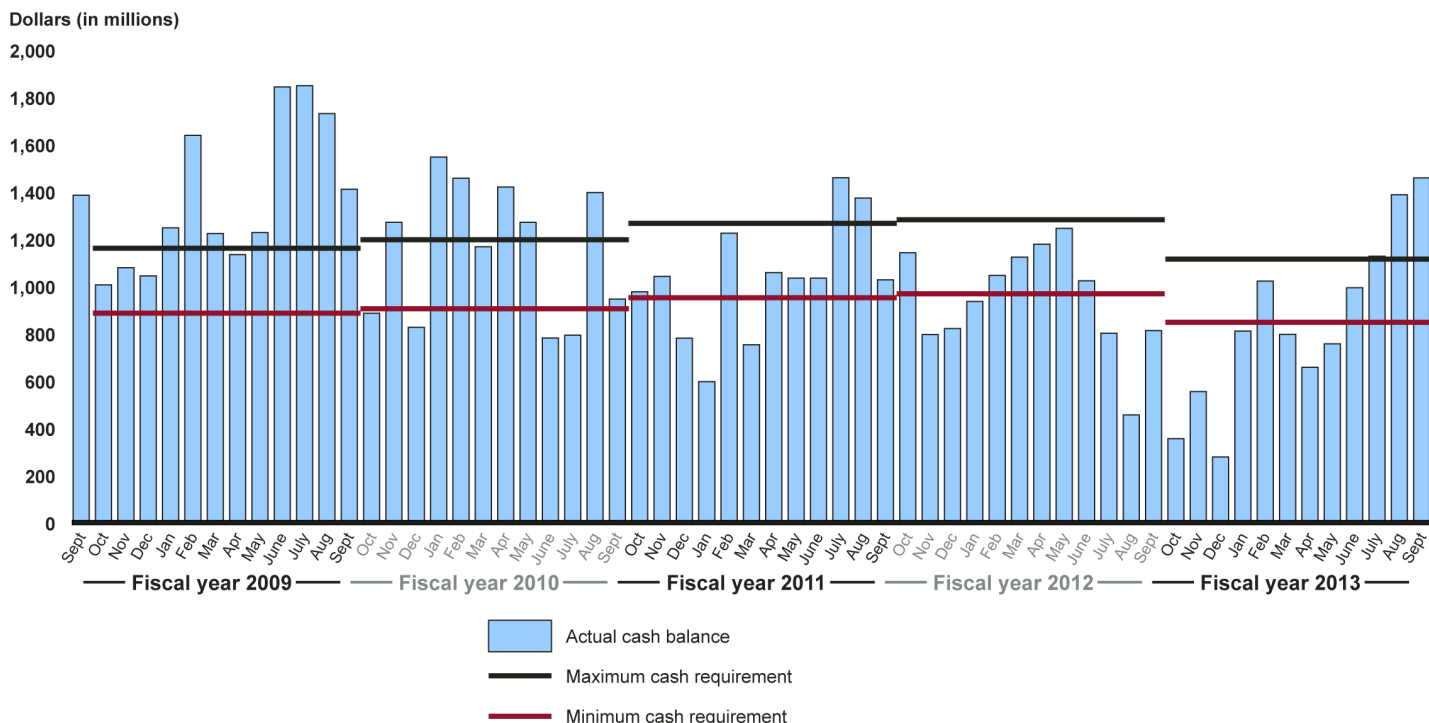
In June 2010, the DOD Financial Management Regulation was amended to allow DOD working capital fund activities, with the approval of the Office of the Under Secretary of Defense (Comptroller), Director of Revolving Funds, to incorporate into the formula for calculating the minimum and maximum cash requirements three new adjustments. These adjustments would increase the minimum and maximum cash requirements. First, a working capital fund may increase the minimum and maximum cash requirements for the amount of accumulated operating results planned for return to customer accounts. The working capital fund returns accumulated profits back to its customers by reducing future prices so it can operate on a break-even basis over time. The second adjustment allowed by the revised DOD Financial Management Regulation is an allowance for funds appropriated directly to a working capital fund that are obligated in the year received but not fully spent until future years. The adjustment allows the working capital fund to retain these amounts as an addition to its normal operational costs. Finally, a working capital fund may increase the minimum and maximum cash requirements by the marginal cash required to purchase goods and services from the commodity/business market at a higher price than was submitted in the President's Budget. The adjustment reflects the cash impact of the specified market fluctuation.

¹³In developing the budget for a particular fiscal year, the Air Force calculates the minimum and maximum cash requirements based on budgeted information, such as budgeted disbursements. The Air Force updates that calculation the next fiscal year based on more current information.

AFWCF Monthly Cash Balances Did Not Consistently Fall within the Minimum and Maximum Cash Requirements

The AFWCF's monthly cash balances fell within the minimum and maximum cash requirements about one-third of the time during fiscal years 2009 through 2013. Our analysis of AFWCF cash data showed that the AFWCF monthly cash balances fluctuated significantly from fiscal years 2009 through 2013 but were almost equally distributed above, between, and below the minimum and maximum cash requirements. The AFWCF monthly cash balances were above the maximum cash requirement for 19 of the 60 months, between the minimum and maximum cash requirements for 21 of the 60 months, and below the minimum cash requirement for 20 of the 60 months. Figure 1 shows the AFWCF monthly cash balances compared to the minimum and maximum cash requirements for fiscal years 2009 through 2013.

Figure 1: Air Force Working Capital Fund (AFWCF) Monthly Cash Balances Compared with Minimum and Maximum Cash Requirements



Source: GAO analysis of AFWCF cash data. | GAO-14-480

Our analysis of the AFWCF monthly cash balances showed that the average monthly cash balance declined each year from fiscal year 2009 through fiscal year 2013. Further, as monthly cash balances declined (1)

more months were above the maximum cash requirement in fiscal years 2009 and 2010 compared to the next 3 fiscal years and (2) more months were below the minimum cash requirement in fiscal years 2012 and 2013 compared to the prior years. Table 1 shows AFWCF monthly cash balance information for each of the 5 fiscal years reviewed and the number of months the AFWCF cash balances were above, between, or below the minimum and maximum cash requirements.

Table 1: Air Force Working Capital Fund (AFWCF) Monthly Cash Balance Information for Fiscal Years 2009 through 2013

Dollars (in millions)

Fiscal year	AFWCF average monthly cash balance	Change in average monthly cash balance from prior year	Number of months compared to minimum and maximum cash requirements		
			Above	Between	Below
2009	\$1,368		8	4	0
2010	1,146	(\$222)	6	2	4
2011	1,029	(117)	2	7	3
2012	947	(82)	0	6	6
2013	849	(98)	3	2	7

Source: GAO analysis of AFWCF cash data. | GAO-14-480

Our analysis of AFWCF financial documents and discussions with Air Force headquarters, Air Force Materiel Command, and USTRANSCOM officials provided the following information on the AFWCF monthly cash balances and the relationship of the monthly cash balances to the minimum and maximum cash requirements from fiscal years 2009 through 2013. First, the monthly cash balances were generally high in fiscal years 2009 and 2010 because the Air Force charged more than it cost for spare parts. Second, the monthly cash balances fluctuated because of the cyclical nature of events, such as the DOD operating under a continuing resolution. Finally, large-dollar transactions, such as transfers in and out of the AFWCF, affected the monthly cash balances. These factors affecting the AFWCF cash balance are discussed further in the sections that follow.

Monthly Cash Balances Were High in Fiscal Years 2009 and 2010 Because the Air Force Set Its Rates Too High for Supply Items

The AFWCF entered fiscal year 2009 with a cash balance of \$1,384 million—about \$224 million or 19 percent above the maximum cash requirement for fiscal year 2009. Air Force headquarters officials informed us that when they set the rates to be charged to CSAG and SMAG-R customers for supply items in fiscal years 2009 and 2010, they wanted the cash balance to be at the maximum cash requirement because the AFWCF changed the method for charging customers for supply items. Specifically, the Air Force changed the method for charging customers for spare parts from (1) selling individual parts to customers on a transaction-by-transaction basis to (2) charging customers for spare parts based on actual hours flown by aircraft. Because the Air Force did not have historical data on applying the new method, the Air Force wanted to make sure it charged customers enough for supply items so that the AFWCF would have a sufficient cash balance. In doing so, the Air Force charged more than it cost for spare parts, which resulted in a higher-than-expected cash balance. According to Air Force headquarters and Air Force Materiel Command officials and our analysis of financial documents, the monthly cash balance was above the maximum amount for 14 of the 24 months during fiscal years 2009 and 2010.

Monthly Cash Balances Fluctuated Because of the Cyclical Nature of Events

Air Force headquarters, Air Force Materiel Command, and USTRANSCOM officials informed us that fluctuations in the AFWCF monthly cash balances occurred because of the cyclical nature of events that affect the AFWCF. Customer orders do not execute in a smooth pattern throughout the fiscal year but instead fluctuate on a seasonal basis as discussed below. These seasonal fluctuations can result in cash balances falling below the minimum cash requirement early in the fiscal year and rising above the maximum in the second half of the fiscal year.

- In the beginning of the fiscal year, the monthly cash balances generally decrease if DOD operates under a continuing resolution because AFWCF customers' funding is constrained, which, in turn, suppresses customer demand for AFWCF goods and services.¹⁴ For fiscal years 2009 through 2013, except for fiscal year 2009, DOD operated under a continuing resolution. For example, our analysis of fiscal year 2012 financial reports showed that for November 2011,

¹⁴A continuing resolution is an appropriation act that provides budget authority to federal agencies to continue their operation when Congress and the President have not completed action on the regular appropriation acts by the beginning of the fiscal year.

December 2011, and January 2012, the AFWCF monthly cash balances were below the minimum cash requirement. In another case, our analysis of fiscal year 2010 financial reports showed that for the first 3 months of fiscal year 2010, the AFWCF monthly cash balances were lower than the ending cash balance for fiscal year 2009. The October and December 2009 cash balances were below the minimum cash requirement.

- Beginning in the April and May time frame and continuing through the summer months, the AFWCF monthly cash balances generally increase because the Air Force flies more training missions during these months because of the better weather conditions. The additional hours flown results in the CSAG and SMAG-R earning more revenue, which, in turn, increases AFWCF collections and its monthly cash balance. For example, our analysis of financial reports showed that in fiscal year 2009, the three highest AFWCF monthly cash balances were in June, July, and August, as shown in figure 1. For these 3 months, the monthly cash balances were above the maximum cash requirement by over \$500 million. In another case, our analysis of financial reports showed that in fiscal year 2011, the two highest AFWCF monthly cash balances were in July and August, as shown in figure 1. For these 2 months, the monthly cash balances (1) were the highest cash balances for the fiscal year and (2) were the only two months when the monthly cash balance was above the maximum cash requirement.

Monthly Cash Balances Were Affected by Large-Dollar Transactions

Air Force headquarters, Air Force Materiel Command, and USTRANSCOM officials stated that fluctuations in the AFWCF monthly cash balances also occurred because of large-dollar transactions, such as appropriations received by the AFWCF or large transfers to and from the AFWCF. These fluctuations occurred in the month that a transaction was made and resulted in large fluctuations in the cash balance from month to month as well as the monthly cash balances fluctuating from below the minimum cash requirement to above the maximum cash requirement or vice versa. For example, at the end of August 2010, the AFWCF monthly cash balance was \$1,395 million (above the maximum cash requirement). During August 2010, the AFWCF received an \$847 million appropriation to fund fuel increases. If the AFWCF had not received this appropriation, the August 2010 monthly cash balance would have been \$548 million (below the minimum cash requirement).

On the other hand, the AFWCF cash balance fluctuated downward and was reduced when transfers were made from the AFWCF to other

appropriations. For example, the Air Force transferred \$251 million out of the AFWCF in the last quarter of fiscal year 2009. These transfers (\$105 million in July 2009 and \$146 million in September 2009) reduced the amount of cash that was over the maximum cash requirement. Specifically, the September 2009 AFWCF cash balance was over the maximum cash requirement by about \$249 million. If the \$251 million had not been transferred, the AFWCF fiscal year 2009 ending cash balance would have been over the maximum cash requirement by about \$500 million.

Further, large transactions can affect the monthly cash balances for several months and thus affect the AFWCF's ability to fall within the minimum and maximum cash requirements. In developing the fiscal year 2013 AFWCF budget, the Air Force set its fiscal year 2013 rates to return prior year gains to its customers. Air Force officials informed us that the fiscal year 2013 rates were expected to lower the AFWCF cash balance by about \$500 million and the projected cash balance would be close to the minimum cash requirement. However, the cash balance fell below the minimum cash requirement because of an unplanned \$370 million transfer from the AFWCF made in August 2012.¹⁵ The transfer was needed to fund overseas contingency operations requirements, such as aircraft depot maintenance. From September 2012 through May 2013, the monthly cash balance was below the minimum cash requirement for 8 of the 9 months. If the \$370 million transfer had not occurred, the monthly cash balance would have been above the maximum cash requirement for 4 months, between the minimum and maximum cash requirements for 3 months, and below the minimum cash requirement for 2 months. From June 2013 through September 2013, the monthly cash balance was between or above the cash requirement.

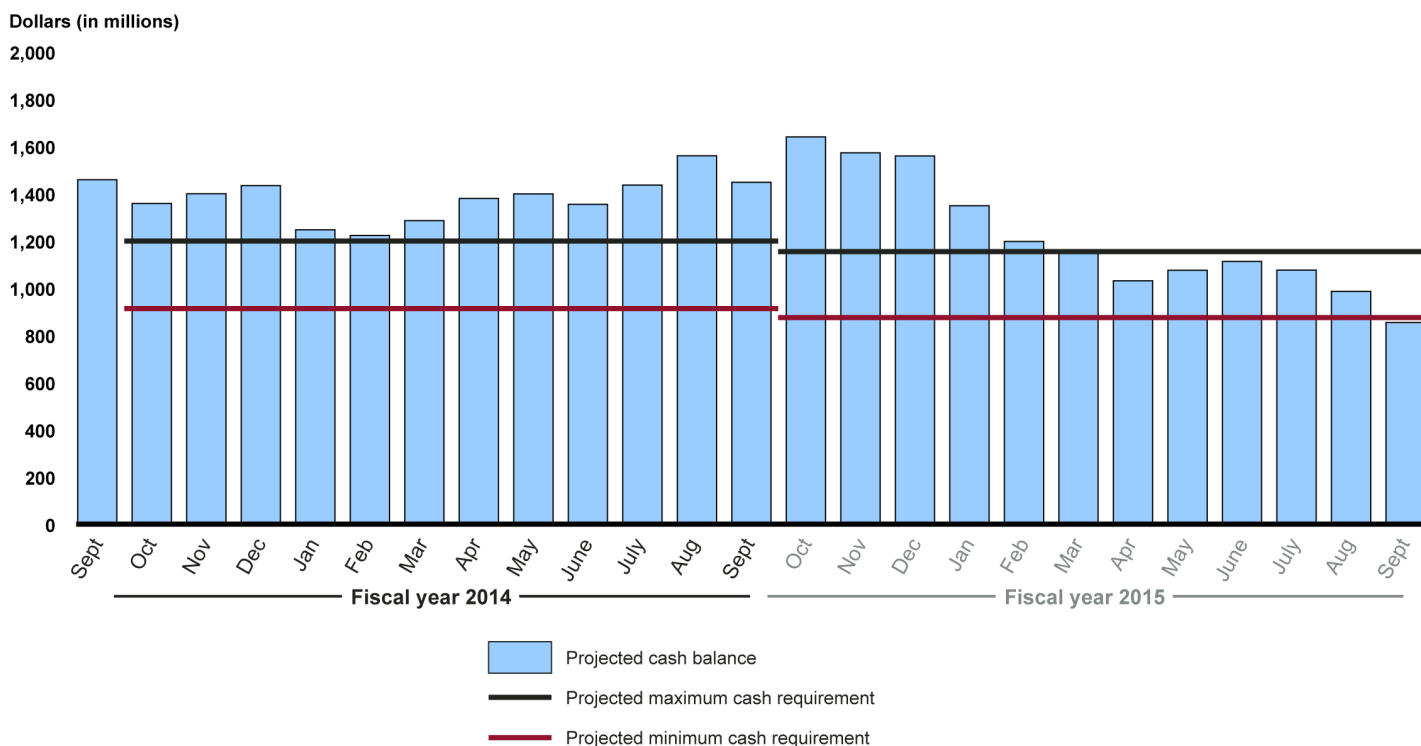
For further details on the cash balances for fiscal years 2009 through 2013, see appendix II.

¹⁵The transfer was unplanned because the process to determine prices begins about 2 years in advance of when work is actually received and performed. Further, this transfer occurred in August—at the end of fiscal year 2012.

AFWCF Monthly Cash Balances Are Projected to Be Above the Maximum Requirement in Fiscal Year 2014 but to Fall Below the Minimum Requirement by the End of Fiscal Year 2015

The AFWCF's fiscal year 2015 budget information shows that the fund's projected monthly cash balances are only expected to fall within the minimum and maximum cash requirements about 25 percent of the time in fiscal years 2014 and 2015. Specifically, our analysis of the AFWCF's fiscal year 2015 budgeted information that contains its cash management plans for fiscal years 2014 and 2015 showed that the projected monthly cash balances are expected to be above the projected maximum cash requirement for the first 17 months, between the projected minimum and maximum cash requirements for the next 6 months, and below the projected minimum cash requirement for the final month. Figure 2 shows the AFWCF projected monthly cash balances compared to the projected minimum and maximum cash requirements for fiscal years 2014 and 2015.

Figure 2: Air Force Working Capital Fund (AFWCF) Projected Monthly Cash Balances Compared with Projected Minimum and Maximum Cash Requirements



Source: Fiscal year 2015 AFWCF cash management plan that provides AFWCF projected cash balances for fiscal years 2014 and 2015. | GAO-14-480

Our analysis of AFWCF financial documents and interviews with AFWCF headquarters officials identified two reasons for the fiscal year 2014 projected AFWCF cash balances being above the projected maximum cash requirement: (1) the AFWCF entered fiscal year 2014 with a cash balance (\$1,458 million) that was above the projected maximum cash requirement for fiscal year 2014 by about \$260 million or 22 percent and (2) the AFWCF is building or maintaining a higher cash balance in preparation for the October 1, 2014, implementation of a Treasury initiative to provide visibility over daily cash balances for all appropriations, including the AFWCF. The higher cash balance is needed to cover the volatility in the daily cash balance. By the final month of fiscal year 2015, the projected AFWCF cash balance is expected to decrease below the projected minimum cash requirement. The projected decline occurred because of an expected shortfall of \$927 million in the Airlift Readiness Account (ARA) resulting from the Air Force including only a portion (\$150 million) of the total projected fiscal year 2015 ARA requirement (\$1,077 million) in the fiscal year 2015 Air Force operation and maintenance appropriated budget request. Further, achieving the AFWCF projected cash balances in fiscal year 2015 depends on the Air Force and USTRANSCOM successfully implementing cost reduction and efficiency initiatives to save \$620 million during that fiscal year.

Daily Cash Balance Reporting Could Increase Minimum and Maximum Cash Requirement for the AFWCF

Treasury is modernizing and streamlining its reporting processes through its government-wide accounting initiative. One result of this initiative will be for Treasury to provide daily cash balances for all appropriations, including the AFWCF, beginning in fiscal year 2015. Currently, the cash balance is visible only in official reports at the end of each month. In preparation for DOD's implementation of Treasury's initiative, the Office of the Under Secretary of Defense (Comptroller) initiated a study in February 2013 to evaluate the impact daily cash reporting will have on working capital fund policies and management. The goal of the study was to assist working capital fund managers to identify necessary modifications to current controls, processes, and policies needed to prevent potential Antideficiency Act violations. As part of the study, the Air Force and USTRANSCOM collected daily disbursement and collection data from their systems to determine the impact these transactions had on their daily cash balances. In analyzing these data, they noted the following.

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- The AFWCF's day-to-day cash balances are more volatile than cash balances measured on a monthly basis and can fluctuate by hundreds of millions of dollars on a given day. These fluctuations increase the risk that the cash balance could become negative on a particular day.
 - DOD systems generally bill customers once or twice a month. The billing systems run in the middle of the month and at the end of the month. Since disbursements are made daily, the daily cash balance is generally at its lowest level at about the middle of the month before the first billing cycle occurs for that month.

Air Force and USTRANSCOM officials informed us that managing cash daily rather than monthly will require them to take two actions. First, these officials stated that the AFWCF will need to maintain a higher cash balance to offset the day-to-day volatility of cash during the month. The higher cash balance will reduce the risk that (1) the AFWCF daily cash balance will become negative on a particular day during the month and (2) the AFWCF will incur a potential Antideficiency Act violation. However, the Air Force and USTRANSCOM have not determined how much the minimum and maximum cash requirements should be increased to cover the additional cash needed. Second, the Air Force is considering adding another billing cycle for the work performed by depot maintenance to increase collections during the early part of the month and offset disbursements made during the same time period.

The implementation of Treasury's initiative to provide daily cash balances was planned for October 1, 2014 (beginning of fiscal year 2015). However, according to Office of the Under Secretary of Defense (Comptroller) officials, DOD systems will not be ready to provide the necessary data to meet the implementation date because (1) DOD has multiple disbursing systems and nonintegrated disbursing locations and (2) DOD has a requirement to protect classified or sensitive information. As of May 2014, the officials stated that they have not established a new implementation date.

When DOD implements Treasury's daily cash initiative, the Financial Management Regulation will need to be updated to reflect the new requirement for daily, rather than monthly, cash reporting. Office of the Under Secretary of Defense (Comptroller) officials acknowledged that the policies in the Financial Management Regulation would be affected by the new requirement. The following examples in the Financial Management Regulation illustrate where updates will need to be made to reflect the new requirement for daily cash reporting.

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- According to the DOD Financial Management Regulation, volume 2B, chapter 9, “cash levels should be maintained at 7 to 10 days of operating cost plus six months of capital disbursements.”¹⁶ The Financial Management Regulation further provides the formula for calculating the minimum and maximum cash requirements, which are aimed at managing cash on a monthly basis. As previously stated, the Air Force and USTRANSCOM study showed that day-to-day cash balances are more volatile than monthly cash balances. Office of the Under Secretary of Defense (Comptroller) officials stated that DOD will need to take into consideration the additional cash needed to cover the day-to-day volatility in the cash balance and update the methodology for calculating the minimum and maximum cash requirements.
 - According to the DOD Financial Management Regulation, volume 3, chapter 19, “it is a violation of the Antideficiency Act if a fund’s cash goes below zero at the close of the monthly reporting period.”¹⁷ Fundamentally, any disbursement in excess of available cash in the fund is a potential violation of the Antideficiency Act. Further, because the AFWCF will show daily cash balances instead of monthly cash balances as a result of Treasury’s initiative, Office of the Under Secretary of Defense (Comptroller) officials informed us that this policy will need to be updated to address a violation of the Antideficiency Act if a fund’s cash goes below zero on a daily basis instead of a monthly basis.
 - According to the DOD Financial Management Regulation, volume 4, chapter 2, every defense component with cash accounts must perform detailed reconciliations of its cash accounts. Specifically, according to the regulation, “reconciliations must be performed at least monthly to ensure the accuracy and reliability of entity fund records and integrity of the financial statements” and “reconciliations must be completed within 10 workdays following the end of the month being reconciled.”¹⁸ Because the DOD Financial Management Regulation currently requires reconciliations to be performed on a

¹⁶See DOD Financial Management Regulation 7000.14-R, *Defense Working Capital Funds Activity Group Analysis*, vol. 2B, ch. 9, p. 9-6 (June 2010).

¹⁷See DOD Financial Management Regulation 7000.14-R, *Working Capital Funds*, vol. 3, ch. 19, p. 19-6 (October 2008).

¹⁸See DOD Financial Management Regulation 7000.14-R, *Accounting for Cash and Fund Balances with Treasury*, vol. 4, ch. 2, p. 2-14 (December 2009).

monthly basis, our analysis showed that this policy will need to be updated to recognize that DOD has visibility over daily cash balances, especially if the cash balances become negative during the month. For example, if the cash balance becomes negative on a particular day during the month, a reconciliation will need to be performed to determine if the cash balance is actually negative or if an error had occurred in determining the cash balance.

While DOD realizes that the Financial Management Regulation needs to be revised to effectively implement Treasury's initiative to provide daily cash balances, DOD has not revised it to include guidance on (1) Treasury's initiative to provide daily cash balances instead of monthly cash balances, (2) maintaining sufficient cash balances on a daily basis to avoid potential Antideficiency Act violations, and (3) the reconciliation of daily cash balances to ensure the integrity and accuracy of the data. Further, DOD has not determined the full impact of Treasury's initiative to provide daily cash balances for the AFWCF or developed an analytical approach for calculating the minimum and maximum cash requirements to adjust for the day-to-day volatility of cash balances in the AFWCF and reduce the risk that the AFWCF may incur an Antideficiency Act violation. Once the updated cash requirement is determined, this will affect whether the projected AFWCF cash balances for fiscal year 2015 will be above, between, or below the cash requirement. Internal control standards state that policies, procedures, techniques, and mechanisms are needed to enforce management's directives, such as the process of adhering to requirements for budget development and execution. They help ensure that actions are taken to address risks.¹⁹ However, the current DOD Financial Management Regulation does not reflect the effect that daily cash balances will have on the AFWCF and thereby increases the risk of a cash shortage and an Antideficiency Act violation.

¹⁹GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

ARA Funding Is Expected to Be Sufficient in Fiscal Year 2014, but a Funding Shortfall May Occur in Fiscal Year 2015 That Could Affect AFWCF Cash

The DOD Financial Management Regulation contains a provision that pertains to the airlift services provided by USTRANSCOM and that affects the TWCF as well as the AFWCF cash balances.²⁰ To enable it to better compete with commercial providers, USTRANSCOM's airlift rates are set to compete with private sector rates and do not cover the full cost of the Air Force's readiness requirements for military airlift operations. The difference between the full cost and the revenue received from airlift customers is to be provided to USTRANSCOM in the ARA through the use of Air Force appropriated funds. This requirement exists in both peacetime and contingency environments.

USTRANSCOM officials stated that since they set rates that are benchmarked to private sector rates, USTRANSCOM does not recover its full cost of operations and the TWCF incurs losses that in turn result in a lower cash balance. To recover these losses, the TWCF identifies the peacetime and contingency airlift requirements and the customers include these amounts in their budget requests. During the year of execution, the TWCF bills the services once a month. Specifically, the TWCF receives funding from (1) the Air Force to pay for the peacetime airlift requirement (Air Force Operation and Maintenance appropriation) and (2) the military services for the contingency airlift requirement (overseas contingency operations appropriation). Over the last several years, the TWCF has received hundreds of millions of dollars that has helped it maintain cash solvency.

According to the TWCF budget request, USTRANSCOM estimates the fiscal year 2014 ARA funding requirement to be \$150 million plus \$691 million for the contingency airlift requirement, for a total of \$841 million. However, in the fiscal year 2015 TWCF budget, USTRANSCOM estimates the fiscal year 2015 ARA funding requirement to be \$1,077 million, while the fiscal year 2015 Air Force Operation and Maintenance budget provides for \$150 million for the ARA.²¹ This estimated shortfall of

²⁰See DOD Financial Management Regulation 7000.14-R, *Defense Working Capital Funds Activity Group Analysis*, vol. 2B, ch. 9, p. 9-18 (June 2010).

²¹According to the AFWCF fiscal year 2015 budget, the administration has not made final decisions about an enduring presence in Afghanistan after calendar year 2014. Once DOD overseas contingency operations needs for 2015 are determined, a budget amendment package will be transmitted subsequent to release of the budget. According to DOD officials, the overseas contingency operations budget may contain funds for the contingency airlift requirement.

\$927 million could negatively affect the TWCF as well as the AFWCF cash balances. Maintaining sufficient cash balances in the TWCF and AFWCF while minimizing the overall ARA bill to the Air Force presents major management challenges for Air Force and USTRANSCOM. If the ARA is overfunded, the Air Force may not be using its resources efficiently to fund other Air Force program priorities to meet mission requirements. Alternatively, if the ARA is underfunded, reductions to Air Force programs may be required to maintain adequate levels of cash in the AFWCF.

The Air Force and USTRANSCOM have had a history of problems with the Air Force requesting full funding in the Air Force's budget for the USTRANSCOM ARA requirement. For example, according to the TWCF budget, USTRANSCOM included a requirement for \$294 million to fund the ARA in fiscal year 2013, but the Air Force did not include funding for the ARA in the fiscal year 2013 Air Force operation and maintenance budget request. Though the Air Force did not request funding for the ARA in the fiscal year 2013 budget, the Air Force paid its fiscal year 2013 ARA bill.

In reviewing past AFWCF budgets, the Office of the Under Secretary of Defense (Comptroller) has also been concerned with ARA funding issues. To address its concerns on these funding issues, in February 2012, the Office of the Under Secretary of Defense (Comptroller) directed (1) the Air Force to ensure that both the AFWCF and TWCF cash levels are adequate to support operational and mobilization requirements in fiscal years 2013 and subsequent years; (2) the Air Force and USTRANSCOM to determine the appropriate methodology for fully funding USTRANSCOM, including the ARA, and estimating the funding sources for fiscal year 2014; and (3) the Air Force to ensure that it funds its responsibilities for USTRANSCOM, including the ARA, updated for more current workload assumptions, in the fiscal year 2014 budget and all future budgets.

Although the Office of the Under Secretary of Defense (Comptroller) has previously raised concerns about ARA funding issues, the funding issues are projected to continue into fiscal year 2015. As stated above, the estimated funding shortfall of \$927 million could negatively affect the TWCF and AFWCF cash balances in fiscal year 2015. Air Force officials stated that although the AFWCF projected cash balance is expected to be above the projected maximum cash requirement at the beginning of fiscal year 2015, they expect the cash balance to decrease to \$853 million and below the projected minimum cash requirement by fiscal year-end. This

decline is expected to occur because Air Force did not fully fund the estimated ARA requirement in the fiscal year 2015 budget. Air Force officials informed us that it did not fully fund the ARA requirement because it funded other higher-priority requirements.

Air Force officials are aware of the estimated funding shortfall and stated that the ARA funding requirement will be best managed in fiscal year 2015 when they can better estimate the actual ARA funding requirement. Air Force officials stated that Air Force and USTRANSCOM senior leadership currently meet monthly to collaborate on AFWCF cash challenges and will be evaluating the ARA funding during fiscal year 2015—the year of execution. They stated that workload and cash levels are monitored closely during the year of execution and that any potential issues involving workload and cash levels, including ARA funding, would be identified several months in advance and brought to senior leadership's attention. If a shortfall in the AFWCF cash balance begins to materialize in the year of execution because of the unfunded ARA requirement, Air Force officials stated that they have several options, including (1) reviewing ongoing programs funded by the Air Force operation and maintenance appropriation accounts to identify where requirements have changed that would allow the AFWCF to obtain additional funds for the ARA or (2) reviewing their investment accounts for excess funding to transfer to the AFWCF. Air Force officials believe any potential cash shortfall would be identified in sufficient time to take action. While USTRANSCOM officials understand the Air Force's position on funding the ARA, USTRANSCOM officials informed us that they believe it is more prudent for the Air Force to request a significant amount of funding for the ARA in the Air Force budget. These officials further stated that if a funding shortfall occurs, the Air Force faces the risk of transferring large amounts in the year of execution to cover the unfunded requirement.

Because the Air Force plans to address potential ARA cash shortfalls in the year of execution, the AFWCF projected cash balances are currently expected to decline during fiscal year 2015 and be below the minimum cash requirement by the end of fiscal year 2015, which could impair the ability of the AFWCF to maintain adequate cash balances. The ARA funding issue could affect the Air Force's efforts to build cash in anticipation of the Treasury initiative to provide daily cash balances. Because daily cash balances are more volatile, the lower projected cash balance caused by the lack of funding for the fiscal year 2015 ARA requirement increases the risk of a cash shortfall and the risk of a potential Antideficiency Act violation.

Achieving Expected Savings from AFWCF Initiatives Is Necessary to Meet AFWCF Fiscal Years 2014 and 2015 Projected Monthly Cash Balances

As stated previously, our analysis of fiscal year 2015 AFWCF budget information that contains the AFWCF cash management plans for fiscal years 2014 and 2015 showed that the projected monthly cash balances are expected to be above the maximum cash requirement in fiscal year 2014 and decline in fiscal year 2015 and fall below the minimum cash requirement in September 2015. According to Air Force and USTRANSCOM officials, achieving the AFWCF projected monthly cash balances for fiscal years 2014 and 2015 depends on the Air Force and USTRANSCOM successfully implementing cost reduction and efficiency initiatives for fiscal years 2014 and 2015. Specifically, the savings from these initiatives were a factor used to (1) set prices to charge customers in fiscal years 2014 and 2015 and (2) estimate projected disbursements.

Air Force and USTRANSCOM documentation shows that the fiscal year 2015 AFWCF budget includes \$114 million and \$620 million in budgeted savings for fiscal years 2014 and 2015, respectively. For fiscal year 2014, the \$114 million in budgeted savings represents less than 10 percent of the projected cash balance for any month during fiscal year 2014. On the other hand, \$620 million in budgeted savings represents about 73 percent of the \$853 million projected cash balance at the end of September 2015—the lowest projected balance in fiscal year 2015. If the budgeted savings are not achieved, the AFWCF cash balance would be adversely affected because disbursements would be higher than expected, which would reduce the AFWCF cash balance below that already projected.

The Air Force and USTRANSCOM have cost reduction and efficiency initiatives that are designed to reduce costs and related disbursements for fiscal years 2014 and 2015, as discussed below.

- The fiscal year 2015 AFWCF budget includes \$503 million in fiscal year 2015 budgeted savings associated with Air Force initiatives.²² Air Force initiatives to reduce costs and related disbursements include (1) reducing the Air Force workforce at CSAG locations by up to 2,000 personnel, (2) refining forecasting models to more accurately reflect future parts requirements, and (3) reducing government travel and contracts where appropriate.

²²According to an Air Force official, the fiscal year 2015 AFWCF budget does not include any fiscal year 2014 budgeted cost savings from Air Force initiatives.

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- The fiscal year 2015 AFWCF budget includes budgeted savings of \$114 million and \$117 million for fiscal years 2014 and 2015, respectively, for USTRANSCOM initiatives. USTRANSCOM initiatives to reduce costs and related disbursements include (1) reducing management overhead costs by 20 percent by fiscal year 2019,²³ (2) reducing spending on information technology projects, and (3) transferring base operating support costs to Air Force operations and maintenance.

Since the \$620 million in savings initiatives represents 73 percent of the September 2015 projected cash balance, it is critical that the Air Force and USTRANSCOM achieve these savings. If these savings are not realized, it can put a further strain on the AFWCF cash balance, which is already projected to be under the minimum cash requirement at the end of fiscal year 2015. In managing the AFWCF projected cash balance in fiscal year 2015, there are several factors that may affect these balances and increase the risk of an Antideficiency Act violation, including (1) the Treasury cash initiative that will require additional cash to cover the volatility of cash on a day-to-day basis, (2) the lack of funding for the fiscal year 2015 ARA requirement, and (3) initiatives to achieve savings. If a cash shortfall occurs, regardless of the reason, the Air Force will have to determine how to fund the shortfall.

Conclusions

The work that the AFWCF performs supports military readiness by repairing aircraft and engines; selling inventory items (spare parts); and providing air, land, and sea transportation for DOD in times of peace and war. Maintaining the AFWCF cash balance within the minimum and maximum cash requirements as defined by DOD regulation is critical for the Air Force and USTRANSCOM to continue to provide maintenance, supply, and transportation services for their fund's customers. Over the past 5 years, the AFWCF has managed to maintain a sufficient cash balance to pay its bills and sustain operations without disruption even though the cash balances were outside the minimum and maximum cash requirements about two-thirds the time. While the projected cash

²³In July 2013, the Deputy Secretary of Defense directed a 20 percent cut in management headquarters spending throughout DOD by fiscal year 2019. The cuts are designed to streamline DOD's management through efficiencies and elimination of lower-priority activities. The Deputy Secretary of Defense directed the cuts to begin in fiscal year 2015, but stated that to the extent feasible, some cuts could begin in fiscal year 2014 in order to increase savings or reduce the cuts required in later years.

balances are expected to be above the maximum cash requirement for fiscal year 2014 and the first half of fiscal year 2015, Air Force officials face challenges in managing the AFWCF cash in fiscal year 2015. The challenges include Treasury's initiative to provide visibility over daily cash balances for all appropriations, including the AFWCF; funding ARA requirements; and meeting established savings goals for AFWCF cost reduction and efficiency initiatives. First, the Air Force has not determined the appropriate minimum and maximum cash requirements for the AFWCF that will be needed to cover the volatility of daily cash balances that can fluctuate by hundreds of millions of dollars each day and reduce the risk that the AFWCF will incur an Antideficiency Act violation, nor has DOD updated its policies to reflect daily reporting of working capital fund cash balances versus monthly cash balances. Second, the Air Force did not fully fund the ARA requirement in its operations and maintenance budget for fiscal year 2015, which increases the risk of a cash shortfall in fiscal year 2015. Third, it is critical that the Air Force and USTRANSCOM achieve the estimated \$620 million savings in fiscal year 2015 as this represents a significant amount of the fiscal year 2015 year-end cash balance.

Recommendations for Executive Action

We are making three recommendations to the Secretary of Defense to improve the management of the AFWCF's cash balances.

We recommend that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to take the following action:

- Update the DOD Financial Management Regulation to include guidance on (1) maintaining sufficient cash balances on a daily basis to avoid potential Antideficiency Act violations and (2) the reconciliation of daily cash balances to ensure the integrity and accuracy of the data once DOD implements Treasury's initiative.

We recommend that the Secretary of Defense direct the Secretary of the Air Force, in conjunction with the Under Secretary of Defense (Comptroller), to take the following action:

- Develop an analytical approach for calculating the minimum and maximum cash requirements to take into consideration the additional cash needed to cover the day-to-day volatility in the cash balances once DOD implements Treasury's initiative.

We recommend that the Secretary of Defense direct the Secretary of the Air Force and the Commander of USTRANSCOM to take the following action:

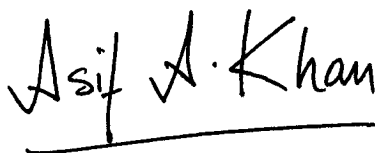
- Take steps to help ensure that the AFWCF receives the appropriate funding if a cash shortfall occurs because of (1) the implementation of the daily cash requirement, (2) a lack of fiscal year 2015 ARA funding, and (3) fiscal year 2015 budgeted savings not being realized.

Agency Comments

DOD provided written comments on a draft of this report. In its comments, which are reprinted in appendix III, DOD concurred with the three recommendations and cited actions planned or under way to address them. Specifically, DOD commented that consistent with forthcoming instructions from Treasury regarding daily cash balances, the Under Secretary of Defense (Comptroller) will revise the Financial Management Regulation on or about the implementation date for daily cash reporting. In addition, DOD stated that while the Financial Management Regulation is in draft, guidance consistent with this recommendation will be published for component submissions of each Program and Budget Review and President's Budget. Further, DOD stated that in the upcoming Program and Budget review (fiscal year 2016), the working capital fund activities will submit information that will provide more clarity to minimum and maximum cash requirements. Finally, DOD indicated that cash levels and potential shortfalls will be monitored closely, and if an unfavorable trend develops, appropriate actions will be taken.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Defense, the Secretary of the Air Force, the Under Secretary of Defense (Comptroller), and the Commander, USTRANSCOM. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9869 or khana@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

A handwritten signature in black ink that reads "Asif A. Khan". The signature is written in a cursive style with a horizontal line underneath the name.

Asif A. Khan
Director, Financial Management and Assurance

Appendix I: Scope and Methodology

To determine to what extent the Air Force Working Capital Fund (AFWCF) monthly cash balances were within the Department of Defense (DOD) minimum and maximum cash requirements for fiscal years 2009 through 2013, we (1) obtained the DOD regulation on calculating the minimum and maximum cash requirements, (2) calculated the cash requirements for fiscal years 2009 through 2013 based on the regulation, and (3) obtained monthly cash balances for fiscal years 2009 through 2013. We compared the minimum and maximum cash requirements to the end-of-month reported cash balances. If the cash balances were above the maximum amount or were below the minimum amount, we met with Air Force and United States Transportation Command (USTRANSCOM) officials and reviewed AFWCF budgets and other Air Force and USTRANSCOM documentation to ascertain the reasons. In addition, we performed a walk-through of the Defense Finance and Accounting Service's (DFAS) processes for reconciling the Department of the Treasury (Treasury) trial balance monthly cash amounts for the AFWCF to the balances reported on the AFWCF cash management reports. Further, to determine the extent cash transfers for fiscal years 2009 through 2013 resulted in the AFWCF cash balances either falling below the minimum cash requirement or being above the maximum cash requirement, we (1) analyzed DOD budget and accounting reports to determine the dollar amount of transfers made for fiscal years 2009 through 2013 and (2) obtained journal vouchers from DFAS that documented the dollar amount of the cash transfers. We analyzed cash transfers to determine if any of the transfers resulted in the cash balances falling outside the minimum or maximum cash requirements and, if so, the amount outside those requirements. We also obtained and analyzed reprogramming documents and journal vouchers and interviewed key Air Force and USTRANSCOM officials to determine the reasons for the transfers.

To determine to what extent the AFWCF projected monthly cash balances were within the minimum and maximum cash requirements for fiscal years 2014 and 2015 and if not why, we obtained and analyzed AFWCF budget documents and cash management plans for the 2 fiscal years. We used the DOD regulation to calculate the minimum and maximum cash requirements for each of those years and compared it to the projected cash balances. If the projected cash balances were above or below the cash requirement, we met with Air Force and USTRANSCOM officials to ascertain the reasons. Further, we interviewed Office of the Under Secretary of Defense (Comptroller), Air Force, USTRANSCOM, and DFAS officials on the initiative to begin receiving daily cash balances in fiscal year 2015 and the potential effect on the

management of the AFWCF cash. We also interviewed Air Force and USTRANSCOM officials to determine what actions the AFWCF plans to take to increase collections or decrease disbursements to avoid potential AFWCF cash shortages.

We obtained the AFWCF financial data in this report from official budget documents and accounting reports. To assess the reliability of these data, we (1) reviewed and analyzed the factors used in calculating the minimum and maximum cash requirements for the completeness of the elements included in the calculation; (2) interviewed Air Force, USTRANSCOM, and DFAS officials knowledgeable about the cash data; (3) compared AFWCF cash balance information, including collections and disbursements that were contained in different reports, to ensure that the data reconciled; (4) obtained an understanding of the process used by DFAS to reconcile AFWCF cash balances with Treasury records; and (5) obtained and analyzed documentation supporting the amount of funds transferred in and out of the AFWCF. On the basis of procedures performed, we have concluded that these data were sufficiently reliable for the purposes of this report. We performed our work at the headquarters of the Office of the Under Secretary of Defense (Comptroller) and the Office of the Secretary of Air Force in Washington, D.C.; Air Force Materiel Command at Wright-Patterson Air Force Base, Ohio; USTRANSCOM at Scott Air Force Base, Illinois; and DFAS in Columbus, Ohio.

We conducted this performance audit from July 2013 to July 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Reasons for Year-to-Year Changes in AFWCF Cash Balances from Fiscal Years 2009 through 2013

Over the 5-year period from fiscal years 2009 through 2013, our analysis of Air Force Working Capital Fund (AFWCF) data showed that the number of months each year (1) above the maximum cash requirement generally decreased and (2) below the minimum cash requirement generally increased. AFWCF officials stated that AFWCF monthly cash balances generally decreased at the beginning of the fiscal year when the Department of Defense (DOD) operated under continuing resolutions because AFWCF customers' funding was constrained, which, in turn, suppressed customer demand for AFWCF goods and services. Beginning in the April and May time frame each year, AFWCF monthly cash balances generally increased because the AFWCF generated more revenue from customers for spare parts that result from the Air Force flying more training mission hours during the spring and summer months because of better weather conditions.¹

This appendix contains the year-to-year analysis of the reasons for fluctuations in the AFWCF cash balances from fiscal years 2009 through 2013. Actual AFWCF cash balances fluctuated each year because of the dollar amounts that were collected by, disbursed by, appropriated to, and transferred to or from the AFWCF.

Reasons for the Change in the Fiscal Year 2009 AFWCF Cash Balance

The AFWCF ended fiscal year 2009 with a cash balance of \$1,409 million—\$25 million more than the beginning balance. Our analysis of financial documents and interviews with AFWCF officials identified three reasons for the net increase in the fiscal year 2009 cash balance. First, the AFWCF collected about \$200 million more than it disbursed because the rates charged to customers of the Consolidated Sustainment Activity Group (CSAG) and the Supply Management Activity Group-Retail for flying hours were higher than the anticipated costs. Second, the AFWCF received about \$76 million in direct appropriations to fund the transportation of fallen heroes killed in military operations and to pay for medical and dental war reserve materials.² Third, the Air Force transferred \$251 million from the AFWCF to other DOD appropriations in

¹The Air Force charges its customers for spare parts based on actual hours flown by type of aircraft.

²Section 562 of the John Warner National Defense Authorization Act For Fiscal Year 2007, Pub. L. No. 109-364 (Oct. 17, 2006), requires the use of military or military contracted aircraft to transport service members who died in a combat theater of operations from Dover Port Mortuary, Delaware, to their final destination.

the last quarter of fiscal year 2009. If the \$251 million had not been transferred, the AFWCF fiscal year 2009 ending cash balance would have been \$1,660 million or \$500 million above the maximum cash requirement.

**Reasons for the Change
in the Fiscal Year 2010
AFWCF Cash Balance**

The AFWCF ended fiscal year 2010 with a cash balance of \$945 million—\$464 million less than the fiscal year 2010 beginning balance of \$1,409 million. The ending cash balance for fiscal year 2010 was between the fiscal year 2010 minimum and maximum cash requirements. Our analysis of financial documents and interviews with AFWCF officials identified three reasons for the net decrease in the fiscal year 2010 cash balance. First, AFWCF disbursements exceeded collections by \$1,054 million primarily because (1) CSAG reduced customer billings associated with the Air Force flying hour program in July and August 2010 to return gains to its customers collected in prior years and (2) the United States Transportation Command reduced its rates for transportation services, relieved the Air Force of its requirement to fund the Airlift Readiness Account, and waived the military services' overseas contingency operations funding requirement (known as the cash recovery charge) because of high balances in the Transportation Working Capital Fund (TWCF) cash account in fiscal year 2010. Second, the AFWCF transferred \$337 million to other DOD appropriations in fiscal year 2010. Specifically, (1) \$250 million was transferred to the Air Force operation and maintenance appropriation to compensate for an equivalent reduction in that appropriation, which was described as excess AFWCF cash; (2) \$47 million was transferred to the Air Force military personnel appropriation to cover shortages in the account; and (3) \$40 million was transferred to the Defense Logistics Agency in support of a process improvement initiative. Third, offsetting some of these reductions, the AFWCF received direct appropriations of about \$927 million that increased the AFWCF cash balance. The appropriations were for TWCF and CSAG fuel price increases, medical and dental war reserve materiel, and support for the transportation of fallen heroes.

**Reasons for the Change
in the Fiscal Year 2011
AFWCF Cash Balance**

The AFWCF ended fiscal year 2011 with a cash balance of \$1,026 million—\$81 million more than the fiscal year 2011 beginning balance of \$945 million. The ending cash balance for fiscal year 2011 was between the fiscal year 2011 minimum and maximum cash requirements. For the fiscal year, financial documents showed that disbursements exceeded collections by about \$3 million. The AFWCF ending cash balance was higher because the AFWCF received direct appropriations of about \$84

million in fiscal year 2011 for medical and dental war reserve material, support for the transportation of fallen heroes, and a TWCF container deconsolidation project.

**Reasons for the Change
in the Fiscal Year 2012
AFWCF Cash Balance**

The AFWCF ended fiscal year 2012 with a cash balance of \$811 million—\$215 million less than the fiscal year 2012 beginning balance of \$1,026 million. The ending cash balance for fiscal year 2012 was below the minimum cash requirement. Our analysis of financial documents identified three reasons for the net decrease in the fiscal year 2012 cash balance: (1) AFWCF collections exceeded disbursements by about \$78 million; (2) the AFWCF received direct appropriations of \$77 million for medical and dental war reserve material, support for the transportation of fallen heroes, and a TWCF container deconsolidation project; and (3) \$370 million was transferred from the AFWCF to the Air Force operation and maintenance appropriation in the last quarter of fiscal year 2012 to fund overseas contingency operations requirements. According to a DOD financial document, the transfer would reduce available cash, but available cash would be sufficient to support AFWCF disbursements.

**Reasons for the Change
in the Fiscal Year 2013
AFWCF Cash Balance**

The AFWCF ended fiscal year 2013 with a cash balance of \$1,458 million—\$647 million more than the fiscal year 2013 beginning balance of \$811 million or \$344 million above the maximum cash requirement. Our analysis of financial documents and interviews with AFWCF officials identified three reasons for the net increase in the fiscal year 2013 AFWCF cash balance. First, collections exceeded disbursements by \$250 million. Second, the AFWCF received \$56 million in direct appropriations for medical and dental war reserve material and support for the transportation of fallen heroes. Finally, \$341 million was transferred from the Air Force aircraft procurement appropriation to the AFWCF in August and September 2013.

Appendix III: Comments from the Department of Defense



COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

JUL 10 2014

Mr. Asif A. Khan
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Khan:

Enclosed is the Department of Defense (DoD) response to the GAO draft report (GAO-14-480), "Air Force Working Capital Fund: Actions Needed to Manage Cash Balances to Required Levels," dated June 11, 2014 (GAO CODE 197128).

Sincerely,

A handwritten signature in blue ink, appearing to read "John P. Roth", is located below the "Sincerely," text.

John P. Roth

Enclosure:
As stated

GAO DRAFT REPORT DATED JUNE 11, 2014
GAO-14-480 (GAO CODE 197128)

“AIR FORCE WORKING CAPITAL FUND: ACTIONS NEEDED TO MANAGE
CASH BALANCES TO REQUIRED LEVELS”

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to update the DOD Financial Management Regulation to include guidance on (1) maintaining sufficient cash balances on a daily basis to avoid potential Antideficiency Act violations and (2) the reconciliation of daily cash balances to assure the integrity and accuracy of the data once Treasury’s initiative is implemented by DOD.

DoD RESPONSE: Concur with comment. Consistent with forthcoming instructions from the Department of Treasury regarding daily cash balances, the Under Secretary of Defense (Comptroller) will revise the Financial Management Regulation (FMR) on or about the implementation date for daily cash reporting. While the FMR is in draft, guidance consistent with Recommendation #1 will be published for Component submissions of each Program and Budget Review and President’s Budget.

RECOMMENDATION 2: The GAO recommends that the Secretary of Defense direct the Secretary of the Air Force, in conjunction with the Under Secretary of Defense (Comptroller), to develop an analytical-based approach to calculate the minimum and maximum cash requirements to take into consideration the additional cash needed to cover the day-to-day volatility in the cash balances once Treasury’s initiative is implemented by DOD.

DoD RESPONSE: Concur. In the upcoming Program and Budget review, the Working Capital Fund activities will submit more granular information that will provide more clarity to minimum and maximum cash requirements.

RECOMMENDATION 3: The GAO recommends that the Secretary of Defense direct the Secretary of the Air Force and the Commander of USTRANSCOM to take steps to help ensure that the AFWCF receives the appropriate funding if a cash shortfall occurs because of (1) the implementation of the daily cash requirement, (2) a lack of fiscal year 2015 ARA funding, and (3) fiscal year 2015 budgeted savings not being realized.

DoD RESPONSE: Concur. Cash levels and potential shortfalls are monitored closely, and if an unfavorable trend develops, appropriate actions will be taken.

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Asif A. Khan, (202) 512-9869 or khana@gao.gov

Staff Acknowledgments

In addition to the contact named above, Greg Pugnetti (Assistant Director), Steve Donahue, Keith McDaniel, and Hal Santarelli made key contributions to this report.

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